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December 14, 1999

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HAND DELIVERY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

RE: Ex Parte Submission; In the Matter of Application for Consent to the Transfer of Control of Licenses, MediaOne Group, Inc. Transferor, to AT&T Corp., Transferee; CS Docket No. 99-251

Dear Ms. Salas:

Enclosed please find the Ex Parte Reply Comments of AT&T Corp. and MediaOne Group, Inc. in the above-referenced proceeding.

Pursuant to sections 1.1206(b)(2) of the Commission's rules, an original and one copy of this letter and the attachment are being filed with the Office of the Secretary. Copies of the letter are also being delivered to the Commission personnel indicated below.

Sincerely,

Howard J. Symons

Enclosure

cc: Deborah Lathen
To-Quyen Truong
Royce Dickens
Sunil Daluvoy
Frances Eisenstein
Walter Strack
International Transcription Service, Inc.

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to	)	
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AT&T Corp., Transferee.	)	

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TABLE OF CONTENTS

Page

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
Applications for Consent to the Transfer of Control of Licenses	)	
	)	
MediaOne Group, Inc., Transferor,	)	CS Docket No. 99-251
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EX PARTE REPLY COMMENTS OF AT&T CORP. AND MEDIAONE GROUP, INC.

INTRODUCTION

The merger of AT&T and MediaOne will provide consumers with choices, services and competition that do not exist today. The Merger will broaden and speed the deployment of an advanced network infrastructure capable of providing consumers with a new generation of video programming services and new choices in markets such as telephony and Internet access.

Unsurprisingly, the prospect of this new and vigorous facilities-based competition has rattled the entrenched incumbents, and none more so than GTE. The "ex parte reply" submitted by GTE[1] amounts to little more than a fervent plea to the government to disable the competition.

[1] *In the Matter of Applications for Consent to the Transfer of Control of Licenses from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*, CS Docket No. 99-251, Ex Parte Reply Comments of GTE Service Corporation, GTE Internetworking, and GTE Media Ventures, Inc. Supporting Denial of Applications or Conditioning Merger on Open Access Requirements (Nov. 1, 1999) ("GTE Ex Parte"). While GTE styles its submission as an "ex parte"

In support of this effort, GTE baldly predicts that the Merged Entity will do no less than exercise "dominant control" over the Internet, thereby warranting rejection of the Merger or the imposition of crippling conditions. GTE's position is utterly meritless.

As the Commission itself has recognized on several occasions, the Internet services marketplace is vigorously competitive. The merger of AT&T and MediaOne does not change the fact that the Internet access services offered by AT&T are and will be subject to competition from numerous other providers. In this environment, any provider attempting to engage in coercive and discriminatory behavior would risk driving both customers and content providers into the arms of its competitors. This risk will be particularly acute for the Merged Entity, since the success of the broadband infrastructure investments made by AT&T and MediaOne depend in no small measure upon their ability to persuade customers to shift from their existing providers. If anything, the acquisition of MediaOne strengthens AT&T's incentive to provide an Internet access offering that is responsive to, and reflective of, consumer needs.

The persistence of narrowband dominance coupled with the rapid deployment and market success of DSL-based services underscore the wisdom of the Commission's policy of regulatory restraint regarding cable broadband services.[2] Nothing about this Merger changes the competitive realities underlying the Commission's policy of regulatory restraint, or warrants any change in the Commission's resolve to address broadband policy issues in generic, industry-wide terms.

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presentation, it is in fact a surrebuttal pleading not authorized by the public notice establishing the pleading cycle in this proceeding.

[2] *See, e.g., In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, Report*, FCC 99-5 (rel. Feb. 2, 1999) at ¶¶ 100-101.

The bankruptcy of GTE's arguments about a future cable broadband monopoly is perhaps most obvious when measured against the extraordinary rise of DSL during the past year. From a base of no customers 18 months ago, the incumbent LECs now have nearly 500,000 residential DSL customers, are adding customers at the rate of more than 100,000 per month, and are growing five times as fast as their cable counterparts.[3] More than 40 million homes will be DSL-capable by year-end -- more than double the homes AT&T and MediaOne will have the ability to serve -- and SBC alone plans to offer DSL to 77 million homes by 2002.[4] Some recent studies now predict that DSL subscribership will pass cable modem subscribership in the near future.[5] And, as AT&T/MediaOne previously has shown, additional broadband providers will enter the market using wireless and satellite technologies.

This analysis is reinforced by the recent statement of Steve Case, Chairman and CEO of AOL. Responding to questions about whether cable modem service would dominate Internet access, he said:

> ... I think it's a little silly to think of cable having a huge lead in this space when the broadband opportunity is only beginning to emerge. The numbers are relatively small. The total number of [subscribers] @Home has after four years in business is less than the net additional subscribers we had for our AOL brand alone in the last three months.[6]

[3] Ex Parte Reply Declaration of Janusz A. Ordover and Robert D. Willig ¶¶ 29-30, 32 ("Ordover/Willig Reply Decl."), attached hereto as Exhibit 1.

[4] SBC's $6 billion initiative, Project Pronto, aims to transform SBC into the largest national broadband provider. *See* "SBC First to Surpass 100,000 DSL Subscribers" (November 4, 1999) <http://www.sbc.com>.

[5] Ordover/Willig Reply Decl. ¶ 29.

[6] *See* Mermigas, Diane, "AT&T in peace talks," *Electronic Media* (Nov. 1, 1999) at 20. As the Cable Services Bureau recently observed, "even the most optimistic estimates [for broadband deployment] predict that narrowband will still be the dominant subscribed form of Internet access by 2005." "Broadband Today, A Staff Report to William E. Kennard, Chairman, Federal Communications Commission, on Industry Monitoring Sessions Convened by Cable Services Bureau" (Cable Services Bureau, October 1999) ("*Broadband Today*") at 32; *see also Power Lunch*, Television Interview with Steve Case (CNBC Broadcast, September 28, 1998) (in five years, "seventy-five percent of the market will be narrowband because people want it to be as easy and inexpensive as possible.").

Given these market realities, AT&T/MediaOne cannot and will not act in an anticompetitive fashion in the provision of Internet access services. The attached declaration of Janusz Ordover and Robert Willig conclusively refutes the wholly speculative claims to the contrary raised by GTE.

The mere fact that AT&T and MediaOne subscribers will be served by a single entity does not alter the prospect of continued narrowband dominance or the emergence of new broadband competition. Likewise, GTE's proffered speculations on how a broadband provider could use caching, proprietary standards and by other practices disfavor unaffiliated content providers does not in any way show that the Merged Entity is likely to do such things.

GTE's submission asks the FCC to ignore both the competitive vibrancy of the Internet access market and the actual manner, terms and conditions by which AT&T, through Excite@Home, furnishes broadband Internet services to consumers. In particular, GTE:

- presses the Commission to disregard AT&T and MediaOne's current business practices, and to engage instead in a game of "what if." For instance, GTE urges the Commission to ignore the uncontested fact that @Home and Road Runner provide subscribers one-click access to any Internet content and cache Web sites in a wholly non-discriminatory manner, and instead render its decision based upon GTE's hypothetical speculations regarding the future of one-click access and caching;[7]

- urges the Commission to disregard what GTE concedes are "legitimate uses" for Excite@Home and Road Runner's router capabilities and instead view such capabilities as proof of an intention to act anti-competitively, because "the fact that a product can be used for good does not mean that it cannot also be used for evil";[8]

- disparages the competitive prospects of DSL even though the number of DSL subscribers has increased nearly 1500% since the end of 1998 (from 39,000 to 600,000) and DSL service will be available to more than 40 million homes by the end of this year, nearly twice the number of total homes presently served by AT&T and

[7] GTE Ex Parte at 24-25; Ex Parte Reply Declaration of Albert Parisian ¶ 21 ("Parisian Decl.").

[8] *Id.* ¶ 23.

MediaOne and more than twice the number of homes that could receive broadband service from a combined AT&T/MediaOne;[9]

- asserts the primacy of theoretical "market definition" studies (predicated on untested and unrealistic assumptions) regarding the relationship between broadband and narrowband over the stark marketplace reality that AT&T and MediaOne recruit their customers from, and price their services comparably to, narrowband Internet access service.[10]

- urges the Commission to mandate forced access by ISPs to AT&T/MediaOne's cable network, even though GTE itself does not give its cable subscribers a choice of ISPs in connection with the offering of broadband services over its cable systems.[11]

GTE's submission turns the theory of regulation on its head: rather than require the *identification* of an *actual* market failure as a necessary predicate for government intervention, GTE believes that merely *imagining* a *potential* market failure justifies such intervention.[12]

[9] GTE Ex Parte at 20-23. Approximately roughly 50% of MediaOne's 8.5 million homes passed and 51% of AT&T's 26 million homes passed are broadband capable. "Digital Phone Lines Gain Speed," *Interactive Week*, November 8, 1999, <http://www.zdnet.com/intweek/ stories/news/ 0,4164,238809,00.html> ("the number of Digital Subscriber Line customers has . . . jumped to roughly 600,000"). *See also TeleChoice xDSL Deployment Tracking Survey*, End of Third Quarter 1999, <http://www.xdsl.com/content/resources/deployment_info.asp> (Current projections indicate the following expected total xDSL line deployment levels: 575,000 by the end of 1999; 2,107,000 by the end of 2000; 5,103,000 lines by the end of 2001; and 7,655,000 lines by the end of 2002 (numbers combine incumbent and competitive LEC-deployed lines, but exclude HDSL lines)).

[10] GTE Ex Parte at 11-17.

[11] *See* "GTE WorldWind: Cable Modem Frequently Asked Questions," <www.gtecablemodem. com/faq/html> (emphasis added):

> Q. What if I already have Internet access through a commercial provider or through another Internet Service Provider?
>
> A. GTE WorldWind service includes unlimited monthly access to the Internet via GTE.NET, GTE's own Internet Service Provider, plus a full-featured edition of Netscape Navigator or Microsoft Internet Explorer. A commercial provider or another Internet Service Provider can be accessed via GTE's high-speed cable modem service. *However, you will have to pay their current established monthly charge.*

[12] Contrary to GTE's strained suggestion, the Microsoft case provides no basis for imposing a harsh new regulatory regime on cable modem services. GTE Ex Parte at 7. First, while the judge in the Microsoft case specifically found that operating systems constituted a separate and distinct product market in which Microsoft had an indisputable monopoly, no one has shown that

GTE's opposition to this Merger has nothing to do with customer choice and everything to do with GTE's scorched earth campaign to use federal and local regulations and courts to slow down the pro-competitive offerings from others while GTE finally marshalls the DSL resources that for years have been collecting dust on its shelves. Fortunately, the Commission's approach to, and oversight of, the broadband services market has been rooted in a concrete and pragmatic assessment of the competitive forces, economic incentives and technological advances shaping the broadband market. That assessment has led it to conclude that government regulation of cable broadband services is unnecessary and, in fact, likely to be counterproductive. AT&T's letter to Chairman Kennard on December 6, 1999 demonstrates the wisdom of that approach. In that letter, AT&T reiterates its commitment to provide customers with a choice of ISPs for high-speed Internet access over the company's broadband cable systems when existing exclusive contractual arrangements expire. The letter confirms that commercial arrangements, not government mandates, are the best means of encouraging both rapid deployment of high-speed Internet access services and customer choice. GTE's proposals should be rejected, and the Merger should be approved as quickly as possible.

"broadband access" is a market unto itself. Broadband and narrowband providers are competing on speed, price, portability, quality, and applications, and broadband services are priced to remain competitive with narrowband. Thus, there is no way to single out broadband as a separate market on the basis of speed alone. Second, while the Microsoft judge found that <u>none</u> of Microsoft's competitors were capable of challenging the company's monopoly position in computer operating systems, cable companies face competition from hundreds of providers with tens of millions of customers, and cable's broadband competitors include the well-funded ILECs, as well as wireless and satellite providers. Third, while the Microsoft judge found that Microsoft had a "persistent" monopoly in operating systems for more than a few years, cable operators are <u>just beginning</u> to enter the Internet business. Finally, unlike Microsoft, cable operators have no incentive or ability to engage in anti-competitive conduct designed to hurt their rivals.

I. GTE'S EXPERT SUBMISSIONS FAIL TO REFUTE THE FACT THAT THE PRICES, TERMS AND CONDITIONS UNDER WHICH THE MERGED ENTITY PROVIDES BROADBAND SERVICE WILL BE FULLY CONSTRAINED BY COMPETITION FROM A WIDE ARRAY OF PROVIDERS

All of GTE's claims hinge on the assumption that the cable modem services supplied by @Home and Road Runner, which together currently serve only a tiny portion of U.S. Internet subscribers, will in short order dominate the Internet business. GTE cannot conceivably support this position.

Most obviously, competition among numerous strong broadband providers is present today and is accelerating rapidly. GTE's suggestion that cable companies enjoy some kind of broadband "first mover" advantage is completely belied by the fact that DSL is capturing over 100,000 broadband customers per month -- a faster growth rate than is present for cable modems.[13] Contrary to GTE's unsupported claims, cable modem service terms are also constrained by competition from thousands of narrowband service providers, whose tens of millions of subscribers represent the principal target for broadband providers.

A. Accelerated Competition from DSL and Others Will Deter the Ability of Any Broadband Provider to Engage in Anti-Competitive Conduct.

GTE attempts to disparage the near-term competitive prospects for DSL by relying on outdated penetration data and archaic claims regarding geographic limits, but the truth is that DSL is a viable and vigorous broadband competitor with subscriber growth rates that exceed those of cable broadband providers.[14] Even if DSL deployment meets only the most

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[13] Ordover/Willig Reply Decl. ¶ 32.

[14] GTE also claims that DSL is somehow less profitable than cable modem service. *See* Ex Parte Reply Declaration of Dale E. Veeneman and Evertt H. Williams ¶ 8 ("Veeneman/Williams Reply Decl."). GTE provides no support for this claim, which is rather extraordinary given the embryonic stage of broadband service deployment. *See* Declaration of Irwin Gerszberg ¶ 10, attached hereto as Exhibit 2 ("Gerszberg Decl."). Moreover, the pace and scope of DSL roll-out by telcos other than GTE belie claims that DSL investment returns will lag. *Id.* ¶¶ 10-11.

conservative forecasts projected in the next three years, it will impose a thorough competitive constraint on cable broadband providers.[15]

A quick survey of data and deals that have emerged since completion of the pleading cycle in this proceeding underscores the prolific growth of DSL service. The number of DSL subscribers in the nation grew from 39,000 at the end of 1998 to 275,000 by September, 1999, and is projected to reach nearly 600,000 by year-end.[16] The forecasts of 70,000 DSL subscribers by year-end cited by GTE are obviously stale and obsolete. SBC alone passed the 100,000 subscriber mark in October.[17] Together, the BOCs and GTE are slated to reach over 40 million DSL-capable lines by the end of the year, more than twice as many as previously predicted.[18] Meanwhile, the DSL business of so-called "data CLECs" is expected to accelerate rapidly in the wake of the FCC's recent "line-sharing" decision which requires ILECs to unbundle the high-frequency channel of their copper networks in order to facilitate the competitive provision of DSL service.[19] In addition, DSL deployment also is accelerating due to technical advances, such

[15] Ordover/Willig Reply Decl. ¶ 32. Recent developments demonstrate that non-DSL broadband technologies also are being deployed at an accelerated pace and becoming more potent competitive forces. Cisco has announced its intention to offer fixed wireless broadband technology to consumers by end of 2000, and several companies, including DirecPC, eSat, and Gilat, are already offering satellite-based broadband Internet access services. *See* "Cisco hopes to bring Internet to homes, businesses with new wireless strategy," <www.cnn.com/199...12/02/ cisco.internet.ap> (Dec. 2, 1999); "Cisco gets wise to wireless networking," <www.cnet.com/ news/0-1004-2...g+st.ne.1004.thed.1004-200-1475219> (Dec. 1, 1999); Ordover/Willig ¶¶ 33-35.

[16] Ordover/Willig Reply Decl. ¶ 29; "Digital Phone Lines Gain Speed," *Interactive Week*, November 8, 1999, <http://www.zdnet.com/intweek/stories/news/ 0,4164,238809,00.html> ("the number of Digital Subscriber Line customers has . . . jumped to roughly 600,000").

[17] Ordover/Willig Reply Decl. ¶ 27.

[18] *Id.* ¶ 30.

[19] *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Third Report and Order, CC Docket No. 98-147 (rel. December 9, 1999). *See also* "Ruling seen heating DSL competition," *Boston Globe*, November 19, 1999 at D1; Ordover/Willig Reply Decl. ¶ 31.

as the introduction of the G.lite ADSL modem standard, which facilitates roll-out of DSL by eliminating the need for truck rolls and facilitating the provision of DSL-ready personal computers.[20]

In mid-October, SBC announced plans to spend $6 billion deploying DSL service to 77 million customers within the next 3 years.[21/] Ultimately, SBC intends to make broadband services available to all 100 million of its customers nationwide -- which represents about one-third of the country's access lines.[22/] SBC stated that even before the announcement of its new $6 billion DSL initiative, it was slated to "deploy DSL in California twice as fast as cable modems are rolled out" and that it will now roll-out DSL service in several other areas faster than cable modems.[23/] SBC also recently announced that it will be bundling its DSL offerings with the Internet access service offered by Prodigy Communications, an ISP with roughly 1.25 million subscribers.[24] SBC will spend $1.6 billion to take a 43% stake in Prodigy, and intends to steer new customers "toward Prodigy service, which will be co-branded with SBC's regional brands -- Ameritech, Pacific Bell, Nevada Bell, SNET, and Southwestern Bell."[25]

[20] Ordover/Willig Reply Decl. ¶ 30 n.29; Gerszberg Decl. ¶ 19; *see also* AT&T/MediaOne Reply Comments, Exhibit J, Declaration of Kenneth A. Shulman ¶ 11 ("Shulman Decl.").

[21] "SBC to Offer a Broadband Vision," *Washington Post*, October 16, 1999, E1.

[22] "SBC Launches $6 Billion Initiative to Transform it Into America's Largest Single Broadband Provider," *Business Wire*, October 18, 1999.

[23] "SBC Details $6 Billion Spending Plan to Increase Broadband Access," *Communications Daily*, October 19, 1999.

[24] "SBC-Prodigy Deal Aims to Secure DSL Customers," *Interactive Week*, November 22, 1999, <http://www.zdnet.com/intweek/stories/news/0,4164,2398628,00.html>. Combining SBC's current Internet access service base with Prodigy's customers gives the combined entity over 2 million subscribers. SBC has committed to sell Prodigy to an additional 1.2 million customers over the next three years. *Id.*

[25] "SBC Will Bundle DSL Service With Prodigy Internet Access Service," *Telecommunications Reports*, November 29, 1999 at 9-10.

Other ILECs also have been taking steps to accelerate their roll-out of DSL service and boost their subscriber base. US WEST has expanded its DSL deployment, claiming that DSL sales are outpacing cable modem sign-ups in its 14-state region.[26] US WEST also has announced plans to furnish voice, high-speed Internet and 167 channels of video over copper wires though VDSL technology.[27] Bell Atlantic now projects that it will have more than 500,000 high-speed customers by year-end 2000. Bell Atlantic offers consumers a substantial discount on installation of its DSL service if they select as their ISP BellAtlantic.net, which features "exclusive Net guides [to] help you organize your Internet browsing."[28] Customers who order InfoSpeed DSL service from BellAtlantic.net will receive their $99 service connection for free and a DSL modem for $99.[29]

GTE itself has been accelerating DSL-related activities, reflecting its view that "customer demand for super-fast Internet access is exploding."[30] From November 10 through year-end 1999, GTE is waiving the one-time installation fees -- which range from $99 to $340 -- for its high-speed Internet access service currently offered in 17 states.[31] Moreover, GTE will provide

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[26] Gerszberg Decl. ¶ 9; *see* "US West Adds MegaBit Services Customer Every 80 Seconds," *RBOC Update* (September 1999), v.10 i9.

[27] *Id; see also* Remarks of Sol Trujillo, "If You Build It, They Will Come (Build It Right, and They Will Stay)," <www.uswest.com/about/speeches> (November 2, 1999).

[28] <http://www.bellatlantic.net/home/banet/south/#BANetGuide>.

[29] <http://www.bell-atl.com/adsl/more_info/pricing.html>. By contrast, customers choosing one of Bell Atlantic's "DSL ISP Partners" must pay the $99 service connection fee and are charged $325 for obtaining a DSL modem from Bell Atlantic. *See* <http://www.bell-atl.com/adsl/more_info/pricing_isps.html>. In addition, DSL subscribers who choose an ISP other than BellAtlantic.net generally pay higher monthly rates than the $49.95 charged to subscribers who obtain DSL from Bell Atlantic.

[30] "GTE continues to make it easier for customers to enjoy high-speed Internet access. Waives one-time installation fees for DSL service through the remainder of the year," Press Release, November 10, 1999, <http://www.gte.com/AboutGTE/newscenter/newsreleases/dslfreeinstall.html>.

[31] *Id.*

additional, special incentives to customers who select GTE.Net as their ISP, waiving "the one-time Internet access fees, which previously totaled $50 per customer."[32] As Ordover and Willig observe, the data regarding the growth and pace of DSL deployment and subscribership "are totally inconsistent with the idea that DSL providers are having difficulty selling their product because of network effects -- *i.e.*, because cable modem service got off to a faster start and has a larger installed base."[33]

While GTE claims that technical limitations constrain the roll-out of DSL service to residences that are more than 18,000 feet from a central office, it is apparent that those constraints are rapidly disappearing. In its announcement that it would provide DSL service to 77 million customers by 2002, SBC stated that it would "push fiber deeper into its neighborhoods and install or upgrade 'neighborhood broadband gateways' containing digital electronics -- essentially pushing network capabilities now housed in central offices closer to customers."[34/] SBC's network redesign "will eliminate distance constraints that currently limit service reach and enable SBC to provide nearly all customers with DSL service, traditional phone service and next-generation services, all from a single, integrated platform."[35/]

SBC's announcement belies GTE's assertions regarding DSL limitations. In addition to the solutions to the putative DSL distance constraints set forth in AT&T/MediaOne's Reply

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[32] *Id.*

[33] Ordover/Willig Ex Parte Reply Decl. ¶ 39.

[34] "SBC Launches $6 Billion Initiative to Transform it Into America's Largest Single Broadband Provider," *Business Wire*, October 18, 1999.

[35] *Id.; see also* "SBC Details $6 Billion Spending Plan to Increase Broadband Access," *Communications Daily*, October 19, 1999 ("Technology upgrades are designed to overcome one of key challenges to widespread DSL deployment - that customers must reside within 3.5 miles of central office to receive service").

Comments, [36] additional remedies are being developed by equipment manufacturers such as Adtran, Inc., that will permit the provision of DSL services to customers located up to 30,000 feet away from their carrier's central office.[37] Indeed, GTE's experts concede that "there is no technical reason why incumbent LECs cannot increase the availability of xDSL services by collocating DSLAMS at the DLC sites, or by upgrading existing DLCs to incorporate DSLAM functionality."[38] Having conceded that technical solutions exist to address constraints associated with furnishing DSL more than 18,000 feet from a central office, GTE's now claims that it is simply "not profitable" to invest in those solutions.[39] As Mr. Gerszberg explains, any limitations on GTE's willingness to build-out DSL services are entirely self-inflicted.[40] For example, Veeneman/Williams state that GTE is behind in DSL deployment because it decided it would be more profitable to upgrade its Internet backbone network than to commit capital and resources toward providing ubiquitous DSL coverage within its territories.[41] At the same time, GTE seeks to hedge its bet by inflicting crippling investment disincentives on cable broadband providers, in order to slow the pace of broadband infrastructure deployment to a timetable more to GTE's liking. It is obvious how this tactic fulfills GTE's competitive and economic interests. It is equally obvious that the tactic completely defeats the public interest. While GTE is certainly free to invest in technologies and services it deems to be most profitable, it is disingenuous to

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[36] *See generally* Shulman Decl. ¶¶ 14-19.

[37] Gerszberg Decl. ¶ 17.

[38] *See* Veeneman/Williams Reply Decl. ¶ 14.

[39] *See id; see also* Gerszberg Decl. ¶¶ 12-16.

[40] *Id.* ¶ 13.

[41] Venneman/Williams Reply Decl. ¶¶ 8, 16.

claim that the government should hobble cable broadband providers that are ready and willing to make investments and confront business risks that GTE shuns.[42]

B. Narrowband Services Also Impose a Significant and Substantial Competitive Constraint Upon the Provision of Cable Broadband Services.

The success of the business plan underlying the AT&T/MediaOne Merger will depend upon the Merged Entity's ability to persuade consumers to switch from the array of narrowband Internet access providers on the market to the broadband offering furnished by AT&T/ MediaOne. Without question, this will be a daunting challenge. There are currently over 100 million Internet users nationwide,[43] and AOL alone serves over 19 million subscribers.[44] Given these numbers, it is unsurprising that the FCC's Cable Services Bureau believes narrowband will continue to be the "dominant form of Internet access" for the next five years.[45] As AT&T and MediaOne previously have explained, to obtain customers for their cable modem services, AT&T and MediaOne must convince customers with narrowband service -- most of whom use their Internet service for e-mail, instant messaging, chat groups, and other popular applications that work perfectly fine on narrowband service -- to switch. It is for precisely these reasons that

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[42] Gerszberg Decl. ¶¶ 6-7.

[43] Ordover/Willig Reply Decl. ¶ 23.

[44] "AOL Acquires Tegic Communications," AOL Press Release (Dec. 1, 1999).

[45] *See supra* n.6. GTE erroneously states that an Internet publication's interview with Excite@Home CEO Thomas Jermoluk "confirms virtually every point GTE has made in this proceeding." GTE Ex Parte at 11-13. This claim is completely without merit, since it is founded upon massive distortions and mischaracterizations of Jermoluk's statements. For example, GTE asserts that his acknowledgment of the nascency of the broadband business and the fast-changing nature of the Internet service market -- "The vast majority of our planning is within a two-month horizon" -- amounts to a concession that AT&T/MediaOne's "conduct will not be disciplined by competitors' actions two or three years in the future." GTE Ex Parte at 12-13. Such mischaracterizations wholly undermine the credibility of GTE's arguments.

AT&T and MediaOne have continued to price their broadband Internet service competitively with narrowband offerings currently on the market.[46]

Unable to ignore the inconvenient facts of both continued narrowband dominance and broadband providers' business decisions to price their services competitively with narrowband access, GTE labors mightily to render these facts irrelevant. GTE begins by asserting that while broadband constrains narrowband, the converse is not true. To support this contention, GTE posits the absurd argument that the two can be considered substitutable only if narrowband service supports video and home networking applications, and "all the other broadband services *that have yet to be invented*."[47]

While GTE's experts decline to embrace that view, they urge the Commission to ignore the critically important effect of pricing on the migration of customers into broadband, and to consider only whether broadband customers would switch back to narrowband service in response to a broadband price increase.[48] These positions, however, fundamentally misconstrue the test for relevant product markets set forth in the Department of Justice's *Horizontal Merger Guidelines*.[49]

The *Merger Guidelines* deem product A to be a substitute for product B if a price increase in one of the products yields a loss of sales to the other product. A "loss of sales" can occur either because fewer subscribers will switch from narrowband to broadband in the first place, or because broadband subscribers will revert back to narrowband. In the real world, of course, any provider would consider both impacts in deciding whether to raise prices, because

[46] Public Interest Statement at 71; AT&T/MediaOne Reply Comments at 72; Ordover/Willig Reply Decl. ¶ 105.

[47] GTE Ex Parte at 18 (emphasis added).

[48] Hausman/Sidak Reply Decl. ¶ 21.

[49] Ordover/Willig Reply Decl. ¶¶ 81-86.

both mean fewer customers and less revenue. As Professors Ordover and Willig demonstrate, GTE's attempt to focus on only the latter effect cannot be reconciled with the *Merger Guidelines*, established economic principles, or common sense.[50]

Drawing upon an analogy offered in the Gertner affidavit, GTE suggests that to contend narrowband is a substitute for broadband is tantamount to contending that rail service is a substitute for airline service, even though no one would view a train trip from Washington, D.C. to Chicago as substitutable for a plane trip due to the slower mode of transport.[51] But a Washington. D.C. traveler bound for downtown New York City might view a Metroliner trip as a substitute for plane service. AT&T has no way of ascertaining which of its subscribers are "Chicago-bound," and which are "New York City-bound." Even if a segment of broadband customers are price-insensitive, AT&T has no way of distinguishing between customers that are broadband-dependent and customers that choose broadband over narrowband based upon their own price/value assessment of the similarities and differences between the two. In order to succeed, AT&T must set its price and offer its service based upon the presumption that narrowband constrains broadband.[52]

Equally unavailing are GTE's efforts to disparage the marketplace evidence showing price similarities between narrowband and broadband. Both Gertner and Hausman-Sidak take issue with the Commission's own findings earlier this year that the monthly cost of cable broadband Internet access is the same as the monthly cost of dial-up Internet access, and that

[50] *Id.* ¶¶ 85-86.

[51] GTE Ex Parte at 19; Gertner Reply Decl. ¶ 7.

[52] GTE argues that Jermoluk has suggested that broadband and narrowband are not in the same market. GTE Ex Parte at 11-12. In fact, the referenced statement says nothing other than that broadband and narrowband have different features that may accommodate different uses by consumers, just as an all-wheel drive car may accommodate different uses than a rear-wheel drive car, even though they are both in the same market.

"total first-year costs" were actually lower with cable modems.[53] Hausman-Sidak question the inclusion of the costs of a second telephone line in the price comparison, but the support offered for excluding such costs consists only of anecdotal evidence that some college students use primary lines for computer use only while utilizing wireless phones for voice communications.[54] This hardly constitutes a credible basis for discarding second line costs in the broadband/ narrowband price comparison, particularly since the Internet usage assumptions underlying Hausman and Sidak's "profile" of marginal broadband customers strongly militates against presuming that they would utilize only a single line.[55] Hausman-Sidak also contend that the installation costs of a cable modem connection should have been taken into account in the Commission's pricing analysis. In fact, the Commission did take such costs into account, even though installation costs for Excite@Home are often waived.[56]

Hausman-Sidak's assertion of an $8.38 monthly price differential between cable broadband and narrowband service is predicated upon several tenuous assumptions, even though

[53] *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 14 FCC Rcd. 2398, ¶ 87, Chart 3 (1999); Hausman/Sidak Reply Decl. ¶¶ 22-23 & n.18.

[54] Hausman/Sidak Reply Decl. ¶ 22 & n.17. Similarly, Gertner asserts "many" homes do not purchase a second line for Internet access, but provides no quantitative data to support this assertion. Gertner Reply Decl. ¶ 12.

[55] Hausman/Sidak Reply Decl. ¶ 30.

[56] *See, e.g.,* "Home Excitement: Promo Gives AOL Subscribers a Taste of Cable Access," *Telephony* (July 19, 1999). Hausman-Sidak contend that the FCC erred by taking into account computer modem costs in calculating annual narrowband prices, since modems often are included in computer purchase orders. Hausman/Sidak Reply Decl. ¶ 22, n.18. Consumers intending to utilize cable modem or DSL service, however, can reduce their computer purchase costs by opting not to include a 56 Kb modem in their PC providers. Moreover, the impact of including computer modem costs in the narrowband price model is offset by the fact that cable modem installation costs are often waived.

it does take into account the costs of installing a second line.[57] First, they compare Excite@Home's monthly access charge with the price charged by Erol's, an ISP that offers no content. Had Hausman-Sidak utilized AOL's monthly price instead, the putative $8 price differential would have disappeared entirely.[58] Second, they ignore an entire category of costs associated with dial-up service: the per-call or per-minute usage charges of the local telephone company.[59] Third, Hausman-Sidak take into account the price of a cable modem installation, even though such costs are often waived.[60] In short, Hausman-Sidak have provided scant basis for the Commission to revise its findings regarding the price similarity between narrowband and broadband.

Notwithstanding the shortcomings of their data, Hausman-Sidak assert that the alleged price differential they have identified is even greater due to differences in service quality between narrowband and broadband. The assertion that the *quality-adjusted* price of narrowband is different from broadband prices is suspect, however,[61] since dial-up access via a second line has certain advantages relative to cable modem service that Hausman-Sidak do not consider.[62] As Ordover and Willig explain, even giving credence to such a notion would not justify discarding the entire $20 monthly cost for a second line in making a price comparison between narrowband and broadband. Moreover, the Hausman-Sidak "quality-adjusted" comparison does

[57] Hausman/Sidak Reply Decl. ¶ 25 & n.21; Ordover/Willig Reply Decl. ¶ 103.

[58] *Id.* Bell Atlantic charges $19.95 for its monthly narrowband Internet access service, which also virtually eliminates the price differential posited by Hausman/Sidak. *See* <http://www.bellatlantic.net/home/banet/north>.

[59] Ordover/Willig Reply Decl. ¶ 103.

[60] *Id.*

[61] *See* Hausman/Sidak Reply Decl. ¶ 22.

[62] Ordover/Willig Reply Decl. ¶ 104. For example, a second line can be used for telephone calls and faxes. *Id.*

not take account of telephone usage charges paid by some dial-up narrowband users.[63]

Professor Gertner states that in "analyzing market definition, it is important to distinguish (to the extent possible) between the price of access and the price of content."[64] Gertner, however, never explains why this distinction is important (other than as a means of boosting support for his argument of substantial price differential between narrowband service and Excite@Home). Given that AOL, the leading provider of narrowband Internet access, bundles content and connectivity, the distinction proffered by Gertner is immaterial. Likewise, Gertner's enumeration of low-cost ISPs also is inapposite, since none of the providers listed, either individually or in the aggregate, wield any significant market share.

Gertner's allusion to low-cost narrowband ISPs actually undermines Hausman-Sidak's contention that a broadband customer's refusal to switch back to narrowband in the face of a five percent price hike is evidence of a lack of substitutability. Indeed, the consumer behavior predicted by Hausman-Sidak is not even readily observable in the narrowband market. If Hausman-Sidak's theory is correct, customers of AOL and other narrowband ISPs who pay upwards of $20 per month in Internet access charges should be flocking to the low-cost ISPs offering listed in the Gertner Declaration that offer Internet access for $0-$10.[65] That this is not occurring highlights the flaws in the market definition analysis presented by GTE's experts. The fact is that there is a broad market for Internet access service, and consumers make service provider decisions based upon a range of factors -- such as price, access speed, ubiquity of service, content level and quality -- whose importance varies depending upon a customer's

[63] Ordover/Willig Reply Decl. ¶ 57.

[64] Gertner Reply Decl. ¶ 10.

[65] Ordover/Willig Reply Decl. ¶ 89.

particular preferences and needs. [66] The market is simply much broader and more dynamic than GTE's experts labor to make it.

GTE asserts that the broadband customers would be willing to pay significantly more than the prices currently charged for the Excite@Home service, and presents a cross-elasticity study conducted by Hausman-Sidak to support this hypothesis.[67] Putting aside the substantial flaws in the study,[68] actual marketplace experience belies GTE's theory. If GTE's theory is correct, then prices for cable modem service should be significantly higher than the price for narrowband service, particularly in markets, for example, where the combined price of a second phone line and AOL monthly access exceeds $40. Instead, however, broadband providers continue to price their cable modem service competitively with narrowband offerings.

As Ordover and Willig make clear, there is no merit to GTE's implicit view that there must be a uniform price relationship between broadband and narrowband across a variety of geographic markets in order for narrowband pricing to constrain broadband pricing such that they are considered to be in the same market.[69] Goods that are close enough substitutes to belong in the same relevant market sometimes have a low or even negative price correlation.[70] The price differential between broadband and narrowband may vary for a variety of reasons, including promotions and pricing experimentation normally associated with the launch of a new

[66] *See id.* ¶¶ 88-91.

[67] GTE Reply Comments at 19-20; Hausman/Sidak Reply Decl. ¶¶ 24-30.

[68] *See* Ordover/Willig Reply Decl. ¶¶ 94-99. The study is based on highly suspect assumptions regarding the value of time saved by using broadband services, asserts (without supporting) that consumers only consider variances in speed when choosing their ISP, and completely disregards the fact that even customers who care about speed may be unwilling to pay any sort of premium if they have to surrender their e-mail address or instant messaging. *See id.*

[69] Ordover/Willig Reply Decl. ¶¶ 95-96; Hausman/Sidak Reply Decl. ¶¶ 32-36.

[70] Ordover/Willig Reply Decl. ¶ 95.

service, second telephone line prices and usage charges incurred by narrowband users, and the number and type of providers in a particular market.[71]

The cross-elasticity study offered by Hausman-Sidak provides no reason to dispute what is readily observable in the Internet access market: consumers weigh the price/value/and trade-offs between broadband and narrowband, and make a decision on that basis. Given the nascency of broadband service, it is essential to take account of both the dynamic nature of the marketplace and AT&T's incentives to price its service in a manner that maximizes customer penetration and retention.[72] The static analyses presented by Hausman-Sidak and Professor Gertner ignore these crucial considerations.[73] Indeed, if the market was as mechanical and predictable as GTE supposes, then @Home's penetration rate would be far higher and broadband providers would be charging higher prices. The fact that this is not occurring further contradicts GTE's theory, while confirming the statements already provided by AT&T officials that market forces and the challenge of persuading subscribers to switch providers compel AT&T to price @Home competitively with narrowband service.[74]

C. Cable Broadband Providers Have no "First Mover" Advantage or Ability to "Lock-In" Broadband Customers

GTE contends that cable has such a head start over other potential providers with respect to broadband deployment that it will be able to "lock-in" customers. As a threshold matter, this argument is refuted completely by evidence demonstrating that the pace of DSL deployment is on par with cable broadband deployment (and in some markets exceeds cable) and the rate of

[71] *Id.* ¶¶ 95-96.

[72] *Id.* ¶ 96.

[73] *Id.* ¶ 14.

[74] *See id.* ¶¶ 87-90.

growth of DSL subscribership is higher than it is for cable.[75] The data regarding the growth and pace of DSL deployment and subscribership "are totally inconsistent with the idea that DSL providers are having difficulty selling their product because of network effects -- *i.e.,* because cable modem service got off to a faster start and has a larger installed base."[76] Cable therefore enjoys no "head start" or "first mover" advantage.

GTE has failed to show any way in which cable subscribers might be "locked in." Cable broadband subscribers are not inhibited from switching providers because such subscribers bear few, if any, sunk costs.[77] Indeed, both cable and DSL providers are waiving or discounting connection and equipment fees, so switching costs are not high.[78] Moreover, many retail stores -- such as Circuit City, Office Depot, CompUSA, Staples -- are selling cable modem and DSL service, and offer consumers the opportunity to "test-drive" the services, so consumers have the chance to make fully-informed comparisons between broadband providers.[79]

Switching gears, GTE also argues that subscribers might be "locked in" to cable broadband providers because of their desire to obtain content that can only be obtained via cable

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[75] *See supra* Section I.A.

[76] Ordover/Willig Reply Decl. ¶ 39.

[77] *Id.* ¶ 40.

[78] *See e.g.*, "ADSL Acceleration," *Washington Post*, October 15, 1999 at E11 (noting that Bell Atlantic is waiving its set-up costs and offering a full rebate after 60 days of service on its DSL "Home Connection Kits," thereby enabling consumers to obtain for free a $229 package that includes setup, "an all-in-one PCI card from 3Com to plug into a Windows-compatible computer, a CD-ROM of installation software and five "filters" that plug into existing phone jacks" to prevent DSL interference).

[79] *See, e.g.,* "High Speed Strategy: Excite@Home Expands Retail Presence," *CableFAX Daily*, October 20, 1999 at 1; "ADSL Acceleration," *Washington Post*, October 15, 1999 at E11 (noting that Bell Atlantic DSL "Home Connection Kits are available from CompUSA and Staples stores); "DSL for Takeout: Bell Atlantic, 3Com Bring High-Speed Access to Retail," *Telephony*, October 11, 1999 at 9 ("retail outlets such as CompUSA and Staples will have interactive kiosks so customers can try out [DSL] service"); *CableFAX Daily*, November 2, 1999 at 2

modem service.[80] This is nothing more than rank speculation. GTE fails to identify any content offered by Excite@Home that is so unique and compelling as to render consumers unwilling to switch providers.[81] Indeed, content providers have no incentive to lock themselves up with AT&T since doing so would cause them to sacrifice exposure to over 90% of the nation's Internet users. Even if AT&T and/or other broadband providers do develop unique content, there is no evidence that this would harm consumer welfare.[82]

Finally, the Commission should view with great skepticism the claim that it should step in to regulate and restrict any putative first mover advantage that exists solely because the second mover has sat on the technology needed to compete for more than ten years, as the ILECs have done with DSL technology.

II. AT&T HAS NEITHER THE INCENTIVE NOR THE ABILITY TO ENGAGE IN THE TYPES OF ANTICOMPETITIVE CONDUCT IMAGINED BY GTE'S EXPERTS

GTE claims that the Merger will allow AT&T to limit the Internet content available to its subscribers by restricting subscriber access to unaffiliated content or otherwise discriminate against unaffiliated content.[83] GTE's unsupported and speculative allegations are baseless. AT&T/MediaOne demonstrated in their Reply Comments that AT&T@Home provides customers with more meaningful choice than other service providers, by providing an "Internet experience" that freely allows subscribers to navigate the Web.[84] Indeed, AT&T's business and

("Cablevision will hawk 3Com DOCSIS-certified cable modems and self-installation kits at The Wiz locations in Norwalk, CT, potentially eliminating the need for installation truck rolls").

[80] Hausman/Sidak Reply Decl. ¶ 41.

[81] Ordover/Willig Reply Decl. ¶ 40.

[82] *Id.* ¶ 41.

[83] GTE Ex Parte at 24-28.

[84] AT&T/MediaOne Reply Comments at 70-71.